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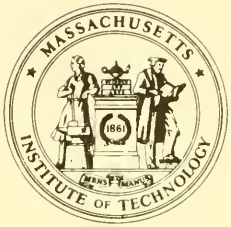

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NATIONALISM AS A DETERMINANT OF THE POLITICAL RISK OF FOREIGN INVESTMENT

Stephen J. Kobrin

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I. Introduction*

Modern nationalism is too often viewed as a secularized analog of the intense religious force that drove the crusaders across Europe in their quest to "liberate" the Holy Land. It is perceived as a non-rational phenomenon with costly consequences. In a well-known article, Harry Johnson noted that, "...to the economist, nationalism appears...as the major political influence responsible for the fact that many features of the policies, concepts, and methods of economic development planning in such (relatively poor) countries either do not make economic sense, or else would make economic sense only in certain specific and rather exceptional economic circumstances...."[1] Johnson relegates the general benefits of nationalism to the realm of "psychic satisfaction,"[2] achieved at a cost.

While there is less than universal agreement about the nature of nationalism, it is clear that its underlying function is basic to the political process in the modern nation-state. We will thus first examine contemporary nationalism as a political phenomenon and then attempt to utilize the understanding gained to determine how it affects foreign investors. It is the thesis of this paper that investors are likely to misread the political climate if they react solely to the intensity of nationalistic expression.

Foreign investors[3] are concerned with the political environment because political factors have the potential to prevent or constrain the achievement of enterprise objectives. If the political environment is relatively stable and changes are both evolutionary and predictable from past trends, its

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contribution to investment risk may be minimal. However, when there are abrupt discontinuities in the political environment and these discontinuities have the potential to prevent the achievement of enterprise objectives, political risk may become a major factor in the investment decision.

It is important to distinguish between risk and uncertainty. Risk describes a situation where while the exact outcome is not known, it does not represent a novelty; probabilities can be calculated. Uncertainty, on the other hand, implies that the outcome cannot be predicted because the situation is novel, the situation has not been observed in the past. Uncertainty entails ex-post surprise rather than a lack of ex-ante belief.[4] Ceteris paribus, overall investment risk(as a function of the premium a given environment requires) will be lower when probabilities can be assigned to both political events and their potential effects upon foreign investors. In theory, planning is not possible under conditions of complete uncertainty where possible outcomes cannot be identified ex-ante. In practice, even if a number of outcomes can be delineated, the inability to assign probabilities limits one to developing plans for a number of contingencies.[5]

Uncertainty is to some extent a function of the position of the observer. An event may be truly novel, or it may appear so because of a lack of understanding of the environment. Thus, an understanding of the political environment, of the structure and functioning of political processes, can reduce novelty or ex-post surprise. It can allow one to convert uncertainty to risk, to assign probabilities which in turn facilitate planning. It is the contention of this paper that by understanding the functions of nationalism and its relationship to the political process rather than reacting to the intensity of its expression, investors can reduce uncertainty and thus the political component of investment risk.

II. Nationalism

Nationalism has proven difficult to understand and a single, coherent and agreed upon theory does not exist. Deutsch, for example, sees nationalism in terms of a "...wide complementarity of social communication" while to Johnson, "it can be conceived of as attaching utility to having certain jobs held or certain property owned by members of the national group rather than by non-members of the national group...."[6] Perhaps more generally, nationalism can be defined in terms of a process through which the individual relates to the modern nation-state, a state of mind in which the supreme loyalty of the individual is felt due to the nation-state.[7]

The social concept of nation, a community of individuals sharing a common ethnic or cultural identity and history, stretches back to the dawn of social history. However, the political concept of state, as the ultimate lawmaking and law-enforcing authority over territory, is a post feudal phenomenon dating from attempts by monarchs to centralize power in the fifteenth and sixteenth centuries. The nation-state,then, is a relatively modern concept; for most of human history (and indeed in much of the world today) the family, village, tribe, pope, emperor or feudal lord served as the primary focus of loyalty.

A nation-state, in the ideal sense, refers to a political unit which governs a nation. Some countries such as Sweden and Holland fit the definition well. Others such as Canada and Belgium and many third world countries such as Nigeria, India and South Africa do not. Many of the ex-colonial third world countries have not existed as nation-states in a historical sense. Rather, they were created through the drawing of lines on a colonial map resulting in an attempt to assert political control over a territory which does not even begin to correspond to a nation as a community of individuals.

Nationalism has taken many forms depending upon its context. In nineteenth century Western Europe, where nations existed as defined historical entities, it represented a commitment to a liberal middle class state, an assertion of individual civil rights over submission to royal authority. In the third world today, nationalism often represents a commitment to a new modern state, the transcendence of historical tribal, village or feudal loyalties. Similarly, there is a wide range of opinion regarding the net benefits of nationalism. It is seen by some as both a cause and effect of modernization, as a basis for cohesion in a fragmented state. Others view it as an atavistic remnant of an earlier era, as a barrier to the development of effective international institutions and international integration. (Obviously, the two are not necessarily mutually inconsistent.)

One can thus find considerable variation in definitions and/or theories of nationalism, in the form in which it appears and in judgments of its value. However, what is important for our purposes is that nationalism is a specific process serving functions which can be identified and studied in the context of the modern nation-state. In this paper we will consider nationalism in terms of a process relating individuals and/or groups to the nation-state.

III. The Functions of Nationalism

In the normal course of events, we typically accept the authority of the central government. We may not be enthusiastic about taxation or conscription, but taxes are generally paid and the draft accepted. The system is perceived as legitimate, as having the right to exercise its authority within a given domain, and in the normal course of events legitimate authority is obeyed.[8]

What is the basis of this legitimacy? Why do we obey governmental authority? It is obvious that it would be virtually impossible to sus-

tain a large scale modern state on the basis of coercion alone. Governments do not have the resources to compel every citizen to obey every edict. Under the feudal system, legitimacy was a function of both mutual obligations and responsibilities and generations of tradition. Later, the absolute monarchs claimed a theological basis -- divine right -- for their authority. But, what about the modern, secular nation-state?

In the modern nation-state legitimacy is a function of the individual's involvement in the system. Unlike the absolute monarchy, or even the liberal middle class state (where property ownership was a requirement for participation) the modern state involves virtually the entire population mobilized through education, urbanization and mass-communications. Legitimacy is a result of individuals perceiving the regime as either reflecting their ethnic and cultural identity or as meeting their needs and interests, or perhaps both.[9] Nationalism is then a process of personal involvement in the national system. It is not an end in its own right, it is a means to achieve other goals through the nation-state.

If nationalism is a process of individual involvement in the nation-state, it follows that it is a historical phenomenon which differs across both countries and time. Its form is a function of both political ideas and social structure.[10] In Western Europe and its derivatives where nation-states have existed for some time as fixed entities, nationalism is predominantly political. It serves to: 1) integrate individuals and groups into the national system, 2) limit governmental authority and secure civil rights,and 3) mobilize sacrifice in times of emergency such as war.

In much of the third world, the social and political system and the functions nationalism performs are quite different. Countries are typically fragmented culturally, linguistically and tribally; the state itself may well

be an arbitrary entity. Under these conditions, nationalism serves a nation building function. It serves to establish the nation-state as a valid social and political entity; to establish a shared identity, a community, and to allow centralization of authority.[11]

IV. Individual Attachment to the Nation-State

Figure I, adapted from the work of H. Kelman,[12] contains a typology describing individual attachment to the nation-state, or integration into the national system, at three system states: consolidation or nation building, mobilization and maintenance. The system states are an attempt to categorize socio-economic and political modes recognizing all of the problems entailed in unidimensional (and unilinear) representation of a complex process. It should be noted that while there may often be a correspondence, system states are not synonymous with stages of socio-economic and/or political development. The typology is obviously an abstraction presented to facilitate analysis and not a representation of reality. The states represent neither a dynamic model of development nor an unambiguous classification. Nations do not pass from consolidation to maintenance in orderly fashion, and there is no reason to expect that at a given moment a country will fit neatly into one of the three states.

Consolidation involves transcending ethnic, cultural, historical and/or local ties and molding a fragmented population into a unified nation. It entails recognition of a common identity, the linking of regions through development of communications and transportation--the establishment of a national market--and the legitimization of a central political authority. Nations undergoing consolidation are generally poor, recently independent, and relatively traditional societies.

Figure I

INDIVIDUAL ATTACHMENT TO THE NATION-STATE

Source of Loyalty	Manner of Integration: Ideological (values)	Participant (roles)	Normative (norms)
Sentimental	commitment to cultural values reflective of national identity	emotionally caught in role of national	acceptance of state as sacred
Instrumental	commitment to socio-economic institutions	functionally dependent on social roles mediated by nation-state	acceptance of commitment to law, order and/or equity
	System States		
	Consolidation	Mobilization	Maintenance

Mobilization of resources may take place in two quite different contexts. In relatively poor countries, mobilization is directed towards an objective of socio-economic development; typically, but not necessarily, industrialization. In more advanced countries resources may be mobilized in response to an emergency such as war or severe economic conditions. (The two may obviously overlap.) Maintenance refers to "normal" conditions in a relatively advanced country.[13]

The source of loyalty is a function of the nature of individual (or group) involvement with the national system. Sentimental loyalty implies that attachment is an end in itself; the nation-state is seen as a reflection or extension of the individual or as an embodiment of cultural values or one's people.[14] Instrumental loyalty implies attachment serves as a means; the national system is perceived as an effective vehicle for achieving the objectives of the individual and/or other system members.[15]

The manner of integration is a function of the system state and the level of development. Consolidation entails the establishment of ties between the individual and the nation; the individual is actively involved, in a psychological sense, with the creation of the nation. The corresponding manner of integration is thus likely to be ideological. The state may be seen sentimentally as an expression of the national identity or it may be viewed as a means through which an ideology, such as socialism, can be implemented.

At the mobilization stage, the individual is typically integrated into the nation-state as participant. If the primary sense of attachment is sentimental, the individual is likely to relate to the national system through the various experience it provides in terms of one's role as a national. If being an American (or Italian or Venezuelan) is important, one is committed

to the United States (or Italy or Venezuela).

On the other hand, if one's source of loyalty is instrumental, the State at the mobilization stage represents a means to accomplish objectives attached to various social roles. A businessman, for example, may be dependent upon the State for physical and communications infrastructure and for a regulatory order which permits the firm to function efficiently.

At the maintenance, individual integration into the national system is typically passive or normative. One may view the State as a sacred entity in itself ("America, love it or leave it") or as a means for achieving other norms such as law and order or equity.

Nationalism or the relationship between individual and state encompasses both sources of loyalty to and the mode of integration into the national system. The explicit manifestation of nationalism, the form of its expression, should then logically be a function of the interaction of attachment and integration which in turn is a function of the system state and the stage of socio-economic and political development.

At consolidation the individual is an active creator of the nation-state as personal (psychological) modes of relating to the new identity are established. The process, the manner of individual integration, is ideological. As the process requires individual emotional involvement, one would expect a relatively intense expression of nationalism.

At mobilization the source of loyalty and the form in which nationalism is expressed varies at different developmental states. In the more advanced countries where mobilization occurs in response to war or economic hardship, sentimental attachment is likely to prevail. In the poorer countries, attachment is likely to be instrumental with the individual integrated as a participant. Mobilization of resources for development involves individuals

in new roles which are likely to be either directly or indirectly dependent on the nation-state. Obviously, neither situation is mutually exclusive. An instrumental attachment may play a significant role in mobilization for war in an advanced country and there may be a major sentimental component in a development effort. However, in general we would expect the individual to be integrated instrumentally--in terms of his or her social roles--at the mobilization state in poor countries and, correspondingly, we would expect nationalism to emerge in functional forms. In advanced countries, the expression of nationalism at mobilization should be more intense, reflecting the sentimental nature of the individual's attachment to the nation-state.

At the maintenance stage, the individual's attachment is normative, role adherence is the basic concern and one would expect nationalism to be passive, aroused only in response to specific stimuli. What is posited then, is that the intensity of expression of nationalism should be a function of both the system state and the stage of development. Its expression should be most intense at consolidation and perhaps during mobilization in advanced countries and least intense at the maintenance state. Mobilization in poor countries should fall someplace in between. Stated another way, excepting instances of war or economic emergency, the intensity of expression of nationalism should decline as a given country evolves from a consolidation to a maintenance state.

We have now, hopefully, described nationalism as an essential political process which serves to relate individuals to the modern nation-state. It should also be clear that the form and substance of the process--its expression and content--will vary over both space and time. We would expect it to be markedly different in France in 1789, in the United States in 1945 and in Nigeria in 1976. Before proceeding to attempt to analyze nationalistic reactions to foreign investment, a caveat is needed. The model used to analyze nationalism

is obviously an abstraction; in practice one would not expect to find clear-cut distinctions between system states or modes of individual integration. Ideological, participant and normative modes of integration may well coexist among various individuals (or perhaps in the same individual) at any given system state.

V. Nationalism and Foreign Direct Investment

The conceptual framework developed thus far is intended as an aid to understanding the functions of nationalism in the modern nation-state: it should be clear that it is not presented as the theory of nationalism. As we are concerned with nationalism as a determinant of political risk,[16] we will now apply the framework to attempt to determine the conditions under which nationalism can (at least potentially) constrain the achievement of enterprise objectives. If the nature and intensity of expression of nationalism varies over space and time, it appears reasonable to posit that its relationship with foreign direct investment will not be constant.

Figure II summarizes the nature of nationalism and likely nationalistic reactions to foreign investment at each of the system states (consolidation, mobilization and maintenance) utilized to examine nationalism in terms of the individual's attachment to the State. The "reactions to foreign investment" are certainly not all inclusive; they are examples of what can be expected at each "stage" given the nature of nationalism and the resources and capabilities of the State. The reader will recall that both the form and function of nationalism differ at mobilization in advanced and poor countries. While we will briefly discuss potential reactions under conditions of mobilization in advanced countries, the second column in Figure II refers to mobilization for development.

Figure II

NATIONALISTIC REACTION TO FOREIGN INVESTMENT

System States

	Consolidation	Mobilization	Maintenance
Nature of Nationalism	intense, emotive, nation-building, creation of we'ness	functional/ instrumental	normative/passive
Reaction to Foreign Investment	1.Foreigner as a symbol - the "they."	1.As instrument of global rather than local optimization	1.As a direct threat to national sovereignty
	2.As a transmitter of foreign customs and culture	2.As constraint on national economic and social control	2.As an agent of the home country government
	3.As immediate manifestation of capitalism	3.As vehicle for technological and/or cultural dependence	3.As a threat to law and order
	4.As evidence of relative gap re industrialization	4.As vehicle for transfer of resources	

Consolidation

At the consolidation state, nationalism serves a nation building function, it attempts to create a sense of unity or "we'ness." In an important sense, the objectives or goals of the country (relative to industrialization, for example) are less important than questions of national identity and the often symbolic manifestations of national cohesiveness and national leadership.[17]

The nationalistic reaction to a foreign investor is thus likely to be a function of its foreignness per se. The foreign company, especially if it is large, important and visible, serves as a symbolic "they," an undesirable foreign presence located within the host country. It is a clear and present "threat," whose immediacy and reality does not have to be either conjured up or magnified. This situation, the immediate presence of visible foreignness, obviously presents opportunities for exploitation by national leaders interested in creating a sense of unity and cohesiveness.

Thus at the consolidation state the primary nationalistic reaction is likely to be against the foreigner qua foreigner. In addition, foreign investors may be seen as corrupters of local customs and traditions; as vehicles for the introduction of alien values, language and culture in general. The problem is likely to be a sensitive one if nation building involves rejection of foreign--typically colonial--language and customs and an emphasis on indigenous culture as is the case in many third world countries. An example is the reversion to Swahili and emphasis on indigenous culture in several Africanization programs.

Foreign direct investment is characterized by a transfer of resources, typically technology, management and perhaps capital from source to host countries. Subsidiaries of multinationals serve as one of the primary vehicles for the introduction of the attitudes, values, institutions and even

formal organizations associated with industrialization in poor countries.[18] In fact, the transfer of resources, of foreign technology and management skills, is the primary justification for foreign direct investment, for equity ownership and control.

However, the reality of the function of foreign investors is not likely to be sufficient to offset sensitivity to the introduction of foreign customs and culture. While a sense of national unity may be a prerequisite for industrialization, the requirements of the two processes may sometimes conflict. Nation building may demand emphasis on internal values while industrialization may require transfers of external resources. While in the longer run, social, economic and political modernization may be interactive, there are often contradictions at early points in the process. And these contradictions generate an ambivalence which can easily take the form of a reaction against foreign investors.

The very function that subsidiaries of foreign corporations perform as transmitters of more advanced technology may well exacerbate the problem. The capabilities of the foreign company and its advantages versus local entrepreneurs may provide immediate evidence of the "gap" between rich and poor countries and serve to salt an already sensitive wound.

If consolidation stage nationalism serves as a means to execute a commitment to a socialist ideology, then foreign direct investment is likely to represent an immediate manifestation of capitalism. If the commitment to socialism entails absolute opposition to private ownership of the means of production, then differences with foreign direct investors are irreconcilable. However, as the recent increase in East-West commercial ties indicates, this does not necessarily mean that other non-equity

contractual arrangements are not possible.

Thus, at the consolidation or nation building stage the nationalistic reaction to foreign investors is likely to be a function of their foreignness per se, their introduction of alien customs and culture or perhaps their very existence as capitalist enterprises. The reaction is like to be highly visible and "noisy" as the development of ties to the nation-state requires active individual emotional involvement and nationalism is thus quite intense.

The substance of the nationalistic reaction, however, may be a different matter. In fact, for a manufacturing (as opposed to an extractive) subsidiary, the probability of the nationalistic reaction resulting in meaningful constraints on operations may be quite low. If the reaction is couched only in terms of an enterprise's "foreignness," then the obvious remedy is nationalization. The reaction is intense and very real, but it is not very specific. It sets up a zero-one situation. At the consolidation stage, governments typically do not have the resources or capabilities to nationalize (and run) manufacturing ventures. While there may well be pressure for local participation, in terms of ownership or management, this again may be difficult to enforce at low levels of socio-economic and political development.

The situation may be quite different in the case of an extractive venture. First, foreign ownership of natural resources has proven to be intolerable for a large number of new nations. Second, the technology needed to operate an already existing extractive enterprise is often readily available on the market. Thus, the pressures to take action may be much stronger than in the case of manufacturing and the consequences perceived as less disabling.

At the consolidation stage, we would posit that the "bark" of nationalism is likely to be much more severe than its "bite." While the reaction is likely to be intense, the probability of meaningful constraints on foreign enterprise may be relatively low. Large scale extractive ventures are quite obviously exceptions. In addition, if a socialist government comes to power, the possibility of macro risk - of all foreign investment being nationalized or expropriated as in Cuba in 1960 - certainly exists.

The conclusions to be drawn by foreign investors are obvious. At the consolidation stage, one should minimize unnecessary foreignness and visibility. It may be worthwhile to adopt a local name and to avoid unnecessary use of home country language and customs. While a transfer of technological and managerial resources is inherent in the function of the foreign investor, it is not clear that this requires widespread use of the home country language, for example, in intra-office transactions or in product names or advertising.[19] Shell, Nestle, and Lever Bros. in the U.S. provide excellent examples of subsidiaries of foreign companies which have blended in with the local environment. One wonders how many Americans would correctly identify them as foreigners? Similarly, it may be possible to increase adaptation to local customs and culture without sacrificing efficiency; in fact, the evidence (and logic) indicates that it may enhance it.[20]

Mobilization

While the threat posed by the foreign investor is primarily symoblic at consolidation, it may well be concrete at mobilization. The process of centralization and legitimization of national power is well along and individuals and groups have developed specific interests and roles vis-a-vis the nation-state. Nationalism then tends to be functional and instrumental, serving to mobilize the resources necessary for development. We would thus posit that while the form of expression of nationalism may be less intense at mobilization[21] than at consolidation, the reaction is substantively strongest at this state as it is often an expression of an underlying conflict between the foreign investor and the nation-state. The conflict is in turn a function of differences in objectives and means.

At least in theory, a multinational enterprise operates on a global basis; it scans a global horizon with reference to both resource allocation and maximization of its objective function (e.g., profits, sales, growth, etc.) Given differences in national tax rates, regulations, exchange controls, etc., there is no reason for a policy of global maximization of profit (for example) to result in maximization of profit in any given country. A subsidiary exists not as an independent entity, but as a sub-unit of the larger system. Its behavior is only partially determined by the conditions faced locally; its reactions are a function of conditions throughout the system and its performance judged relative to its contribution to the overall enterprise.

An individual nation-state, on the other hand, operates on the national level. It is interested in maximizing its objective functions (growth, employment, stability, external equilibrium, equity, etc.) on a national basis. Thus, even if one assumes that maximization of profits by the firm in any given nation results in a maximum contribution to the local economy,

conflict can result if the firm is maximizing globally. Furthermore, attempts by individual governments to capture more of the benefits through exchange restrictions or higher taxes may exacerbate the situation; the firm may respond by shifting profit to other subsidiaries.[22]

A nationalistic reaction may also be generated at the mobilization stage by real or perceived constraints that foreign investors exercise on national social and economic control. This is not the place to enter the lists on the extent of host country versus enterprise power. However, it is clear that subsidiaries of foreign companies are responsive to home country headquarters and through them, to home country governments. They do have a greater capability, vis-a-vis domestic competitors, to subvert fiscal and monetary controls through transfer pricing, transfers of capital or credit and the like. The reality or perception of a dilution of national control, of a perception of constraints on national capabilities to execute socio-economic policies thought necessary for development, can lead to a nationalistic reaction against foreign corporations. At mobilization, this reaction is substantive; it reflects conflict that is primarily concrete rather than symbolic.[23]

Again, the foreign investor's function as a vehicle for the transfer of resources is a two-sided coin. Foreign subsidiaries are often perceived as agents of technological or cultural dependence; as mechanisms for placing the local economy at least partially under the control of an advanced country. In many instances the charge has content, indeed in some cases a degree of dependency may be unavoidable. Inappropriate, overly sophisticated production technologies and products may result in dependence upon an advanced country for maintenance, parts, repair and capital. Extensive advertising may result in a demand for luxury goods that do not serve the

broader needs of the host country. In other cases, a charge of dependence may be strictly polemics, a holdover from the colonial experience. However, what is important is the perception that foreign investors may constrain the mobilization of resources for indigenous development. This perception can, and often does,result in a nationalistic reaction; a reaction based upon a concern that the foreign investor reduces the capacity of the state to serve the needs of its citizens.

Foreign investors may also be charged with transferring needed resources out of developing countries. While the arguments about decapitalization and the "brain drain" are far from settled, it is again the perception that is important.[24] (In summary, at the mobilization stage, a nationalistic reaction is likely to be a function of a concrete conflict between foreign investors and nation-states; a conflict based upon differences in objectives and on the means of achieving them.)

Mobilization for war or economic emergency in an advanced country presents a special case. In the case of warfare, a zero-one situation is likely. If the foreign investor is an ally, or perhaps even a neutral, few problems should be encountered. If the investor is an enemy, expropriation is to be expected. Economic emergencies present a more complex situation. First, the intensity of nationalism is likely to be hightened,and second, concrete areas of conflict may emerge as the host government attempts to implement policy measures to aid recovery. On the other hand, the fact that the host country is likely to be a substantial investor itself is likely to constrain action against foreign investors. Thus, while nationalistic reaction may be quite intense, the probability of meaningful action may be quite low.[25]

The ramifications for foreign investors at the mobilization stage are not clear cut. First, it must be recognized that while political rhetoric often entails the exaggeration of facts, and that the form or intensity of expression of an issue may not be a good indicator of its substance, the conflict between foreign investors and host countries is a real one. Foreign investors can, at the same time, make a net positive contribution to development and constrain the independence of host country governments. Optimization of global objective functions and control exerted by a headquarters located in another country often result in the setting of subsidiary goals which differ from those preferred by policy makers. The perception on the part of host country citizens that foreign investors are interfering with the government's ability to serve their needs can generate a nationalistic reaction.

While conflict may be unavoidable, the reaction can be diffused. Conflict in terms of differences in objectives is inherent in many situations in the economic sphere. However, under a wide range of circumstances there should be a sufficiently large area of overlap between the interests of foreign investors and the host country to allow a reasonable agreement to be reached. An agreement which provides both a contribution to host country development and a reasonable return to the investor. This obviously requires fair and open pre-entry negotiations and a willingness on the part of both sides to compromise for their mutual benefit. The emergence of increasingly sophisticated, knowledgeable and professional "entry negotiators" in the developing countries should aid this process.[26]

Maintenance

At the maintenance system state nationalism is normative and passive and nationalistic reactions to foreign direct investment should be minimal and avoidable. Countries at the maintenance stage are typically developed, both in the socio-economic and political sense, and are often sources of foreign direct investment themselves.

However, while passive, nationalism can be aroused through a perceived threat to the state, either as an entity in itself or as an instrument for maintenance of norms. Three cases come to mind. First, foreign investors can be perceived as directly threatening national sovereignty. Second, they can be seen as agents of the home country government and last, they can threaten norms, such as law and order.

Unfortunately, there have been relatively recent examples of all three situations. ITT's activity in Chile, both in attempting to defeat Allende and then in attempting to prevent his government from taking office was a clear external threat to national sovereignty which would have generated a nationalistic reaction in most countries.[27]

The well-publicized meetings between ITT and officials of the CIA lent credence to a general suspicion that multinationals are agents of the home country's government. The true U.S. business-government relationship lies somewhere between the American claim of arm's-length dealings and the assumption of a partnership often found in other countries. However, there have been sufficient incidents in the past, such as attempts to apply the Trading with the Enemy Act to subsidiaries of U.S. multinationals, to raise fears abroad and to generate nationalistic reactions.[28]

Most multinationals are not threats to law and order, or other norms, in host countries. On the contrary, sensitive about their position as

foreigners and lacking a complete understanding of local customs, they may "bend over backwards" to obey the letter of the law. However, enough exceptions exist to provide examples. The most obvious is Lockheed's activities abroad, particularly in Japan and Italy where the stability of governments has been threatened. The direct threat to stability posed by Lockheed's use of large scale payments to extreme rightist groups to influence Japanese rearmament policy generated a nationalistic reaction, against both the company involved and foreign investment in general. Again, we would expect that such a flagrant and direct violation of norms would generate a strong reaction in most countries.

The conclusions for investors at the maintenance stage are straightforward, at least in theory. If foreign subsidiaries attempt to maintain reasonable standards of corporate citizenship, most nationalistic reactions should be avoidable. However, there are cases which are less than clear cut. For example, should foreign investors accept the norms of South African society as they exist? Doing so may minimize nationalistic reactions in South Africa, but it may well generate intense opposition at home. The question is obviously not easily resolvable.

VI. Foreign Investment and Nationalism: Positive Effects

As has been noted above, this paper has focused on nationalism as a determinant of political risk. We have thus concerned ourselves with the potential negative effects of nationalism, the constraints it can impose upon attainment of enterprise objectives. However, nationalism is neither a force for good nor evil; it is a political process through which the individual is involved in the modern nation-state. Thus it is not unreasonable to expect that nationalism can provide positive benefits for

foreign investors.

First, nationalism facilitates consolidation of the nation-state, the mobilization of resources for development and legitimization of the authority of the central government. Thus, the very function of nationalism in the political process should aid the foreign investor who assumedly prefers a both stable and cohesive polity and socio-economic development.

Nationalism may also provide advantages at the individual firm level. Ford in Brazil or Procter and Gamble's French company co-exist as subsidiaries of U.S. multinationals and Brazilian or French corporations. While their foreign identity may generate antagonism, their "citizenship" may provide for positive benefits from nationalism. An excellent example is provided by Sears and Roebuck of Mexico which decided to source locally to the maximum extent possible, thus developing extensive backward linkages. It could then trade upon the fact that it sold large numbers of Mexican products in its retail outlets. Similarly, if research and development activities located within a subsidiary result in an important breakthrough, it can enhance national pride.

VII. Conclusions

This paper has attempted to view nationalism functionally as a political process through which the individual relates to the modern nation-state. However, both the form and substance of nationalism are in turn functions of political and socio-economic development and they thus vary considerably across both space and time.

The nationalistic reaction to foreign investment should also vary at different levels of political and socio-economic development. Perhaps most important, there is not necessarily a direct correlation between the form of expression and the substance of nationalism. At the consolidation stage, the intensity of expression of nationalism is likely to be quite high, perhaps even violent. Yet, at least for non-extractive sector investment, the likely consequences in terms of meaningful constraints on foreign enterprise may be considerably less threatening.

On the other hand, at the mobilization stage, nationalism is more likely to take a functional form and its expression is often less intense. Yet, it is precisely at this stage when there is the strongest direct relationship between nationalism and a substantive underlying conflict between foreign investor and host country. Thus, at mobilization, nationalism may represent a real threat to foreign investors in terms of increased political risk.[29]

By understanding nationalism (and the political environment in general) investors can reduce political risk. First, there is an inherent human tendency towards ethnocentrism; towards interpreting events in terms of one's own culture. As we have seen, this could be dangerous for an American investor in a third world country where nationalism takes a very different form, and performs a different function, than it does in the U.S. Second, by reacting to the content rather than the intensity of expression of nationalism, foreign investors can minimize conflict to the benefit of enterprise and country alike.

Footnotes

[1]Harry G. Johnson, "A Theoretical Model of Nationalism in New and Developing States." Political Science Quarterly 80 (June 1965): 169-185, reprinted in A Kapoor and Phillip D. Grub, eds., The Multinational Enterprise in Transition (Princeton: The Darwin Press, 1972), p. 325.

[2]Ibid., p. 332.

[3]By foreign investment we mean foreign direct investment which entails sufficient equity ownership in the invested in enterprise to allow the investor (typically, but not exclusively, a business firm) to exercise significant managerial control. This may be contrasted with foreign portfolio investment where the investor purchases a financial instrument (shares of stock or a bond, for example) with neither the intention nor the capability of exercising managerial control. See Charles P. Kindleberger, American Business Abroad (New Haven: Hale University Press, 1969) and John H. Dunning, ed., Economic Analysis and the Multinational Corporation(New York: Praeger Publishers, 1975).

[4]Nicholas Georgescu-Roegen, The Entropy Law and the Economic Process (Cambridge: Harvard University Press, 1971), pp. 122-123.

[5]The possibility of contingency planning under conditions of uncertainty was suggested by Richard D. Robinson.

[6]Karl W. Deutsch, Nationalism and Social Communication (Cambridge: M.I.T. Press, 1953), 104; Johnson, "A Theoretical Model of Nationalism...," in Kapoor and Grub eds., p. 330.

[7] Hans Kohn, Nationalism: Its Meaning and History (Princeton: D. Van Nostrand Co., 1955), p. 9.

[8] Herbert C. Kelman, "Patterns of Personal Involvement with the National System: A Social Psychological Analysis of Political Legitimacy," in James N. Rosenau, ed., International Politics and Foreign Policy (New York: Free Press, 1969), p. 279. The U.S. draft might well be the exception which proves the rule. The first relatively large-scale draft resistance movement in recent times which took place during the later stages of the war in Vietnam, was a direct function of a questioning of governmental legitimacy.

[9] Ibid., p. 283. The conceptual framework used in this paper draws heavily upon the work of Professor Kelman.

[10] Hans Kohn, Nationalism, p. 3.

[11] This function has been discussed under the rubric of integration theories which view nationalism as a "process of successive integration of social groups." For a summary of integration theories, see Chong-do Hah and Jeffrey Martin, "Toward a Synthesis of Conflict and Integration Theories of Nationalism," World Politics XXVII (1974-75): 361-386.

The author experienced a clear example of nation building during a 1973 trip to Peru. At a festival in an Andean village, where most of the population formed a culturally and linguistically distinct group, a government spokesman was acting as master of ceremonies at a presentation of folk music and dancing. Between each act he repeatedly told the audience that what they were seeing was not Spanish or Indian or European or American, it was Peruvian. It was unique and it was theirs. He then went on to say that they were also not Spanish or Indian, but Peruvian.

[12] Herbert C. Kelman, "Patterns of Personal Involvement," p. 280.

[13] Given patterns of dualistic development, two or more system states could conceivably exist simultaneously within a single nation-state. The modern,

industrialized sector, for example, could be concerned with mobilization while consolidation is still the major issue in the traditional sector.

[14]Kelman, "Patterns of Personal Involvement," p. 280.

[15]Ibid., p. 281.

[16]While political risk is regularly used, the correct term should be the political component of investment risk.

[17]It is perhaps at consolidation that Johnson's description of nationalism in terms of the utility attached to having jobs held or property owned by local nationals is most relevant. The reaction is against foreigners, per se.

[18]For a more complete discussion of foreign direct investment as a vehicle for the cross-cultural transfer of attitudes and values see, Stephen J. Kobrin, "Foreign Direct Investment, Industrialization and Social Change," The Journal of Conflict Resolution 20 (September 1976).

[19]At times, foreign names may provide positive benefits in terms of product image. French names for perfumes and English names for high technology/scientific products serve as examples.

[20]For example, see the discussion of adaptation and efficiency among pharmaceutical companies in India in Barry M. Richman and Melvyn R. Copen, International Management and Economic Development (New York: McGraw-Hill, 1972), pp. 416-425.

[21]We are referring, at this point, only to mobilization for development in relatively poor countries.

[22]The important point is that the capability to subvert national economic policy through transfer pricing, remissions, etc., exists and is perceived by host country policy makers as a threat to sovereignty. The extent to which these activities take place is an empirical question which has as yet to be satisfactorily answered.

[23]There is no reason to assume that there will be conflict between the objectives of foreign investors and those of all groups of nationals. Given that some mutuality of interest is probably a requisite of a successful investment relationship between investor and host country, one would expect conflict on some issues and compatibility on others. Furthermore, foreign investment may be directly supportive of the objectives and roles of certain individuals and groups.

[24]See, Thomas Weisskopf, "Capitalism, Underdevelopment and the Future of the Poor Countries," in J.N. Bagwati, ed., Economics and World Order (New York: The Free Press, 1972).

[25]The U.S. in the mid-1970's provides an excellent example. In the wake of 1973/74 OPEC embargo and the subsequent depression, feelings against foreign investment were quite visible. A congressman expressed concern over the ability of OPEC investors to purchase U.S. companies like "meat in the marketplace" and Immetal (a French company) experienced considerable harassment before successfully taking over Copperweld. Yet, to date, there have been no restrictions on inflows of FDI or on the operations of foreign investors.

[26]For a report of a study of entry controls in developing countries, see Richard D. Robinson, National Control of Foreign Business Entry: A Survey of Fifteen Countries (New York: Praeger, 1976).

[27]While the extent of ITT's involvement in Chile has not been fully established, they have admitted an offer of one million dollars to the CIA to help undermine Allende. See The Wall Street Journal, May 15, 1976, p. 5.

[28]The most recent attempt by the U.S. Government to enforce the Trading with the Enemy Act extra-territorially involved automobiles manufactured in Argentina by Ford and G.M. for shipment to Cuba. The U.S. was ultimately unsuccessful in the face of strong protests from the Argentine Government.

[29]Chong-Do Hah and Martin conclude that nationalism, which they define as organizationally heightened and articulated group demands directed toward securing control of the distributive system is primarily a phenomenon of transitional societies. In general, countries mobilizing for development are in a transitional stage. See Hah and Martin, "Toward a Synthesis," p. 384.

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